SUPREME COURT, U. S.

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No. 905

IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

ANCHOR COUPLING COMPANY, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONER'S REPLY MEMORANDUM

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I.

PROPER APPLICATION OF THE "ORIGIN AND CHARACTER" RULE TO THE FACTS AS FOUND BY THE DISTRICT COURT DEMONSTRATES THE ERROR IN THE POSITION OF THE GOVERNMENT.

In its opposing brief the Government insists (pp. 6, 7) that this matter is governed by the "origin and character" test, but it persists in refusing to recognize the actual origin of the lawsuit which gave rise to the taxpayer's litigation expense. In so doing, the Government (like the Court of Appeals) simply rejects the controlling findings of fact of the District Court. Thus the Government (p. 5) states

that the litigation "arose from Borg-Warner's alleged acquisition of title to petitioner's assets under a contract of sale," that "• • • the present case involves expenditures arising directly from petitioner's efforts to sell all of its assets • • •" (p. 7) and, in a footnote (p. 9), the Government states that the litigation "originated in Borg-Warner's claim that title to the assets should be conveyed to it". But the Trial Judge made clear and unequivocable findings as to the "origin" of the lawsuit which gave rise to the litigation expense in question. The litigation arose out of:

> "• • • *negotiations* with Borg-Warner Corporation *with respect to* sale to Borg-Warner of [Anchor's] assets • • •.
>
> "• • • *negotiations* [which] were similar in kind to *negotiations* which had occurred within the prior five years with other prospective acquirers of Anchor's assets.
>
> • • • *negotiations* [which] were *normal occurrences* in the operation of business concerns situated similarly to [Anchor].
>
> "• • • *negotiations* [which] were broken off by plaintiff • • •" (emphasis added, A-1)

In *Woodward* (p. 579) and *Hilton* (p. 587) the litigation expense was held "capital" because it had its origin in the "process of acquisition". In this case the Government ignores the District Court's plain holding that the litigation expense had its origin in the process of normal business negotiations which broke down and resulted in a lawsuit.

The basic fallacy of the Government is that it searches for the "origin" of the Borg-Warner litigation in the pleadings of one party to that suit. That is as irrelevant as would have been an analysis of the pleadings in the bitterly contested divorce litigation which gave rise to the expense in *Gilmore*. In the *Gilmore* case the Court found the "origin"

of the litigation expense in the marital relationship not in an analysis of the charges and countercharges of the spouses.

Petitioner therefore submits that the Government's argument misapprehends the rule of *Gilmore* and substitutes an irrelevant analysis of pleadings for an inquiry into the "origin" of the claims giving rise to the litigation. The Trial Judge heard evidence about the origin of the litigation and made findings of fact about it: it arose out of "normal occurrences" in the business of the taxpayer and the related expense was, accordingly, deductible as an ordinary and necessary expense.

II.

THE GOVERNMENT IGNORES THE CRUCIAL DISTINCTION BETWEEN CASES INVOLVING THE ACQUISITION OR DISPOSITION OF PROPERTY AND THIS CASE WHERE TAXPAYER NEITHER ACQUIRED NOR DISPOSED OF PROPERTY.

The Court in *Woodward* and *Hilton* stressed the distinction between the cases before it where litigation expense was part of the "process of acquisition", and those cases involving the issue of whether expense was incurred in "defending or perfecting title to property". Whatever the difficulties in resolving an issue of whether an expenditure should or should not be categorized as in "defense of title", they are not found in a situation where the expenditure is "clearly a part of the process of acquisition" (*Woodward*, p. 579).

But Anchor's expenditure did not result in the acquisition of any property by it. At most, this case presents a question of "the tax treatment of costs incurred in litigation that may affect a taxpayer's title to property more or less indirectly" (*Woodward*, at p. 577). It calls, therefore, for the application of the "primary purpose" test which,

however "uncertain and difficult", as the Court said in *Woodward* (p. 577) "may be the best that can be devised to determine the tax treatment of costs incurred in litigation that may affect a taxpayer's title to property more or less indirectly, and that thus calls for a judgment whether the taxpayer can fairly be said to be 'defending or perfecting title' ". The Trial Judge properly applied the test and his legal conclusion that the "payment was not made in defense of title" (A-3) was solidly based upon his Findings of Fact (A-1, 2).

III.

THE GOVERNMENT'S SUGGESTION THAT BUSINESS DEDUCTIONS MUST HAVE THEIR ORIGIN IN "CURRENT, DAY-TO-DAY OPERATIONS" TO BE DEDUCTIBLE AS AN ORDINARY AND NECESSARY EXPENSE IS SQUARELY CONTRADICTED BY MANY SUPREME COURT OPINIONS.

The Government (p. 7) suggests that the many cases set forth at pages 9 and 10 of Anchor's Petition are distinguishable because the expenditures "had their origin in current, day-to-day operations". The opinions of this Court do not support any such rule and we submit that the lack of merit in the Government's argument is patent: nowhere is it suggested that there is a special class of business expense characterized as "current, day-to-day" business expense.

The Government concedes (p. 8) that expenditures incurred in "abandoned sales negotiations" are deductible. But certainly nothing could be less "current'" and "day-to-day" than the usual sales negotiation which is abandoned. But as the Trial Judge found, a distinguishing feature of this case is that the taxpayer's negotiations in question were similar to negotiations with other prospective purchasers and were, in fact, "normal occurrences in the operation of business concerns situated similarly" (A-1).

There is, therefore, no support for the "current, day-to-day" gloss on the business deduction rule now suggested by the Government. As we point out in our Petition, the well established test for deductibility of a business expense is whether it is "directly connected with, or * * * proximately result[s] from" the taxpayer's business" *Kornhauser* v. *U.S.*, 276 U.S. 145 (1928) and this "pure question of fact" (*Comm'r* v. *Heininger*, 320 U.S. 467, 475 (1943)) was decided in favor of the taxpayer by the Trial Judge.

CONCLUSION

For the above reasons and those set forth in the Petition for Certiorari, a writ of certiorari should issue to review the judgment and opinion of the Seventh Circuit.

Respectfully submitted,

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January 8, 1971

CERTIFICATE OF SERVICE

I hereby certify that on this 8th day of January, 1971, three copies of the Petitioner's Reply Memorandum were mailed, postage prepaid, to The Solicitor General, Department of Justice, Washington, D.C. 20531. Three additional copies were mailed to the Department of Justice attorneys who appeared for the government in the United States Court of Appeals for the Seventh Circuit.

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